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Planning Considerations for an Audit of a Federally Assisted Program; Auditing Interpretation of SAS No. 22 – Planning and Supervision

American Institute of Certified Public Accountants. Auditing Standards Division

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Planning Considerations for an Audit of a Federally Assisted Program

**Auditing Interpretation of
SAS No. 22—Planning and Supervision**

AICPA

**American Institute of
Certified Public Accountants**

The staff of the Auditing Standards Division has been authorized to issue Interpretations to provide timely guidance on the application of pronouncements of the Auditing Standards Board. Interpretations are reviewed by members of that Board. An Interpretation is not as authoritative as a pronouncement of the Auditing Standards Board, but members should be aware that they may have to justify a departure from an Interpretation if the quality of their work is questioned.

This auditing interpretation appears in the *Journal of Accountancy*, April 1981.

Planning Considerations for an Audit of a Federally Assisted Program

Question

1. The first standard of field work states that “the work is to be adequately planned,” and SAS No. 22, *Planning and Supervision*, gives guidance on planning considerations. SAS No. 22, paragraph 3, states that, “In planning the examination, the auditor should consider matters relating to the entity’s business and the industry in which it operates . . . and the nature of reports expected to be rendered.” Paragraph 7 states that the auditor should obtain knowledge of matters that relate to the entity’s business and its organization, as well as matters that affect the industry in which it operates, such as government regulations, as they relate to his examination.

2. What particular matters should the auditor consider in planning the audit of a federally assisted program?

Interpretation

3. The auditor should be aware of governmental standards for audits of federally assisted programs. These standards may be found in the publication of the U.S. General Accounting Office (GAO) entitled *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*.¹ In planning the audit, the auditor should be aware that GAO standards frequently extend beyond the AICPA’s generally accepted auditing standards, particularly in the following areas:

- Working papers.
- Notification of parties other than the entity’s management about irregularities and illegal acts.

4. Other matters of particular concern in planning an audit of a federally assisted program include:

- Determination of the type of engagement to be performed.
- Identification of the entity.

1. The GAO has proposed revisions to the current edition of its standards.

- Determination of the nature of the financial information to be audited and the appropriate form of reporting.
- Identification of the parties to whom the auditor has reporting obligations.
- Consideration of participant eligibility requirements.

5. *Working Papers.* According to SAS No. 1, section 338, *Working Papers*, the quantity, type, and content of working papers should fit the “circumstances of the engagement.” In the audit of a federally assisted program, these circumstances include access by governmental audit staffs to the working papers and the GAO’s requirement to document the supervisory review. The GAO’s standards require working papers that are clear and understandable without supplementary oral explanations.² Thus, the working papers should not consist solely of work programs or checklists on which the auditor has indicated the steps that have been performed. In accordance with section 338.05, the auditor’s working papers should be in sufficient detail to permit reasonable identification of the work he has done and the conclusions he has reached. Section 338.03 lists appropriate forms of documentation in addition to work programs and checklists, such as analyses, memoranda, and commentaries and schedules.

6. The working papers should document significant aspects of the examination. For example, they should document the auditor’s study and evaluation of the system of internal accounting control as a basis for reliance thereon in determining the nature, timing, and extent of substantive audit tests. They should identify the nature, source, and amounts of the accounting entries or financial items tested and any related evidential matter examined. In addition, working papers should describe the nature of testing procedures performed and provide detailed information about exceptions found and their disposition. Also, the working papers should show that the work of any assistants has been reviewed.

7. *Notification of Parties Other Than the Entity’s Management About Irregularities and Illegal Acts.* The auditor should be aware that governmental standards go beyond AICPA auditing standards

2. The General Accounting Office publication entitled *Guidelines for Financial and Compliance Audits of Federally Assisted Programs* (Washington, D.C.: Government Printing Office, 1980), pp. 12–16, 36–50, gives recommendations on documentation of the review of internal accounting control and tests of account balances and transactions.

as they relate to notification when the examination indicates that irregularities or illegal acts may exist.

8. SAS No. 16, *The Independent Auditor's Responsibility for the Detection of Errors or Irregularities*, paragraph 14, states that the auditor should discuss such matters with an appropriate level of management that is at least one level above the level of those involved. Neither SAS No. 16 nor SAS No. 17, *Illegal Acts by Clients*, requires the auditor to notify parties other than personnel within the client's organization. For example, SAS No. 17, paragraph 19, states that, "Generally, the auditor is under no obligation to notify those parties," and that the decision to notify other parties is the responsibility of management.

9. Governmental requirements, however, call for the auditor not only to promptly report instances of irregularities to the audited entity's management officials above the level of involvement, but also to report the matter to the funding agency or other specified agency.³ The management of the entity being audited typically is aware of this reporting requirement.

10. SAS No. 16, paragraph 14, and SAS No. 17, paragraphs 18 and 19, discuss situations in which the auditor may wish to consult with his legal counsel about withdrawing from the engagement. This guidance would also be appropriate in the audit of a federally assisted program. However, it would not be appropriate for the auditor to withdraw from the engagement without first reporting the irregularity or illegal act to management and appropriate federal agencies.

11. In an audit of a federally assisted program, the auditor may find instances of noncompliance with the terms of a grant award which by their nature are not irregularities or illegal acts. In those situations the auditor should disclose significant instances of non-

3. In October 1979, the Office of Management and Budget (OMB) issued *Attachment P-Audit Requirements* to its Circular A-102, *Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments* (supplemented and revised in August and September, 1980). *Attachment P* gives the OMB the authority to designate a "cognizant agency" to be assigned the audit responsibility for major recipient organizations. *Attachment P* states that the responsibilities of the cognizant agency include acting as a liaison among federal agencies, independent auditors, and recipient organizations, receiving audit reports of the recipient organization and reviewing and distributing them to appropriate federal audit officials, and reviewing notification of irregularities from auditors and informing other affected audit agencies.

compliance in his report, but ordinarily he would not have to otherwise notify the federal agency.

12. *Determination of the Type of Engagement to Be Performed.* SAS No. 22, paragraphs 3 and 4, states that, “audit planning involves developing an overall strategy for the expected conduct and scope of the examination,” and that the auditor “may consider discussing the type, scope, and timing of the examination with management of the entity. . . .” The discussion with management should include an agreement about which of the various types of engagement will be performed, since the GAO’s standards address three types of engagement, any combination of which a federal agency may request the auditor to perform. The first type of engagement is an examination of financial statements and an evaluation of compliance with laws and regulations; the second type concerns efficiency and economy in the use of resources; and the third type considers whether desired program results are effectively achieved. If the auditor is requested to examine financial statements and issue a report on them without also reporting on the evaluation of compliance, he should see if management is aware that such a report might not be acceptable to the GAO, the funding agency, or the agency requiring the audit. If a contract, proposal, or engagement letter is used, the auditor may want to consider including in it a clear statement as to the type of engagement and whether that engagement is intended to meet a federal agency’s requirements or has been approved by the appropriate federal agency.

13. *Identification of the Entity.* Obtaining knowledge of the entity’s organization, as required by SAS No. 22, paragraph 7, is particularly important when the entity receives funds under several governmental assistance programs. The auditor should discuss and reach agreement with management and, if he considers it necessary, with the appropriate federal agency, as to the grants or programs to be audited. If a contract, proposal, or engagement letter is issued, it should set forth the understanding as to the grants or programs to be audited.⁴

14. *Determination of the Nature of Financial Information to Be Audited and the Appropriate Form of Reporting.* In considering the nature of reports expected to be rendered, as required by SAS No.

4. *Attachment P* requires that audits of financial operations of state and local government entities that receive federal aid are to be made on an organization-wide basis rather than on a grant-by-grant basis.

22, paragraph 3(g), the auditor should be aware that in a financial and compliance audit of a federally assisted program his reporting responsibilities may encompass a) financial statements of one or more programs, b) financial statements of an organization having one or more federally assisted programs (an “organization-wide” audit),⁵ or c) selected financial information such as specified elements, accounts, or items of a financial statement of a federally assisted program.

15. The financial statements or information may be presented in accordance with generally accepted accounting principles or on a comprehensive basis of accounting other than generally accepted accounting principles, such as the cash basis or a basis of accounting prescribed by a regulatory agency.

16. In deciding between the standard form of auditor’s report given in SAS No. 2 or some other form of report, the auditor should consider whether the statements constitute complete financial statements and whether they have been prepared in accordance with generally accepted accounting principles.

17. The auditor should follow the guidance in SAS No. 14, *Special Reports*, paragraphs 2–8, when the financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. He should look to paragraphs 9–14, “Reports on Specified Elements, Accounts or Items of a Financial Statement,” and the related auditing interpretations when he concludes that the statements or information do not constitute complete financial statements.

18. If the auditor concludes that financial statements that a federal agency requires to be presented on a prescribed form are in fact presented on a comprehensive basis of accounting other than generally accepted accounting principles, he should follow the guidance in SAS No. 14, paragraphs 2–8, and the related auditing interpretations.

19. If the auditor is required to report on other financial information in addition to the basic financial statements, he should follow the guidance in SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor—Submitted Documents*.

5. See footnote 4.

20. An entity may have several grants or programs, each with separate reporting requirements that may not be met by a report on the entity's basic financial statements. In such circumstances the auditor should consider rendering reports on the individual grants or programs, assuming that the scope of his audit is sufficient for him to do so.

21. When a federal agency audit guide specifies the wording of the auditor's report (for example, on a preprinted form or schedule), the auditor should consider whether that wording calls for assertions that are not consistent with his function or responsibility as described in the contract, proposal, or engagement letter. If there is an inconsistency, the auditor should consider revising the planned work or the wording of the audit report as called for in SAS No. 14, paragraphs 20–21.

22. In all of the situations discussed above, the auditor should be familiar with the GAO's reporting standards as well as the requirements of the applicable federal agency. The GAO's standards call for a report that contains an opinion on the financial statements and explanations of violations of legal or regulatory requirements.

23. *Identification of the Parties to Whom the Auditor Has Reporting Obligations.* To fulfill the requirements of SAS No. 22 (regarding the knowledge of the industry and government regulations) when auditing federally assisted programs, the auditor should obtain an understanding of his reporting obligations to parties other than management of the audited entity. A governmental agency may allow, or even require, the entity being audited to make the audit arrangements with the auditor; however, the agency may still expect the auditor to fulfill its requirements, such as submitting the audit report and reporting irregularities to the agency.⁶ Also, the auditor may have a reporting obligation to more than one agency. For example, a local housing authority may be the contracting agency for an audit of a housing grant, the Department of Housing and Urban Development may be the funding agency, and both may have reporting requirements.

24. *Consideration of Participant Eligibility Requirements.* In planning the scope of the examination, the auditor should obtain knowledge of the nature of the entity's business and consider mat-

6. See the section of this auditing interpretation entitled "Notification of Parties Other than the Entity's Management About Irregularities and Illegal Acts."

ters affecting the industry in which it operates, including government regulations, as they relate to the examination.

25. The nature of some federally financed or sponsored programs is to provide financial assistance to eligible individuals. The eligibility requirements for participation in the program usually are specified in laws, regulations, or contracts applicable to the program.

26. SAS No. 17, *Illegal Acts by Clients*, paragraph 7, discusses the need to consider compliance with laws and regulations. It states that “as part of his examination, the auditor considers laws and regulations that have a direct effect on amounts presented in the financial statements,” and states as an example that “applicable laws or regulations may affect the amount of revenue accrued under government contracts.”

27. Thus, the auditor should plan his audit to test compliance with those laws, regulations, or contractual terms that set forth the requirements for individuals who receive payments under the program. The specific audit objective is to determine that amounts classified in the financial statements as “public assistance expenditures” (or a similar description) should include only expenditures to persons entitled to receive public assistance.

28. In the audit of a student loan program, for example, the auditor should test not only whether payments were made to students but also whether the students met the funding agency’s eligibility requirements on matters such as financial need.

29. If the auditor concludes, on the basis of the evidential matter obtained, that the financial statements should, but do not properly include and classify a liability for payments made to ineligible persons, he should consider the need to qualify his opinion for a departure from generally accepted accounting principles. If he is unable to obtain sufficient evidential matter to form a conclusion concerning the eligibility of persons receiving payments, he should consider whether to express a qualified opinion or disclaim an opinion because of a limitation on the scope of his examination.

30. The auditor should also consider the need to explain in his report violations of regulatory requirements, including instances of noncompliance with eligibility requirements, as required by the GAO’s auditing standards.

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